

**FACTORS INFLUENCING FAMILY BUSINESS
SUCCESSION AMONG FAMILY-OWNED SMALL
BUSINESS FIRMS IN KOTA KINABALU, SABAH**

BY

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Project Paper Submitted in Partial Fulfillment of the Requirement for the Degree of
Master of Management

Open University Malaysia
(2006)

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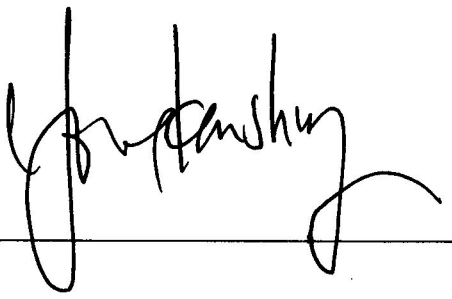


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DECLARATION

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I hereby declare that this project paper is the result of my own work, except for quotations and summaries which have been duly acknowledged.

Signature:  Date: 25/7/02

Thus conscience does make cowards of us all;

And thus the native hue of resolution

Is sicklied o'er with the pale cast of thought;

And enterprise of great pith and moment,

With this regard, their currents turn awry,

And lose the name of action.

Act III, scene iii, Hamlet

William Shakespeare

ACKNOWLEDGEMENT

I would like to express my sincere appreciation to all those who have been helped me all the way to the successful completion of this valuable dissertation. This study would not have materialized without the help and motivation support given by many people directly and indirectly.

First and foremost, I would like to express my sincere appreciation and thanks to my supervisor, Dr. Kalsom Abdul Wahab for her constant assistance, guidance, patience and invaluable support throughout the entire research.

I wish to express my sincere gratitude and appreciation to my beloved parents for their understanding and motivation given to me during the pressured events in completing the research. Their support and understanding are highly appreciated.

A warm note of thanks also goes to all the respondents who have been so kind to participate in this research.

Last but not least, I would like to express my deepest appreciation to my students of Kian Kok Middle School Kota Kinabalu for their encouragement for their invaluable support which is instrumental to the success of this piece of work; and for helped me as the field workers to collect data for my paper.

ABSTRACT

The core purpose of this research paper is to fulfill the requirement as set by the Examination Board and the Centre of Graduate Studies of the Open University of Malaysia for the completion of the Master of Management. The purpose of this study is to identify internal factors influencing small family-owned business firms on the succession process in Kota Kinabalu, Sabah.

Five internal factors are identified associated with perception of family and business success. These are the controllable and predictable factors. To assess the impact of each factor on the ease of business transitions and subsequent family business performance, a survey was directed at the owner/manager of the family business; he or she may be the original founder or the second- or more generation. Suggests that, in successful transitions, heirs are reasonably well-prepared, in term of their education level, training and possessing various managerial skills of working experiences. Beside these factors, a successful family business transition is influencing by the owner's own choice of heir and the selection of gender. The data are from a non-representative sample of 100 family businesses households. Using simple linear regression analysis, the result show the implication of these identified factors on the succession transitional process among Chinese small family-owned business in Kota Kinabalu, Sabah.

ABSTRAK

Tujuan yang terutama kertas kajian ini ialah bagi memenuhi keperluan seperti yang ditetapkan oleh Lembaga Peperiksaan dan Pusat Pengajian Sarjana Open Universiti, Malaysia, untuk penyempurnaan Ijazah Sarjana Pengajian (Master of Management).

Tujuan kajian ini ialah untuk mengenal pasti faktor-faktor dalaman yang mempengaruhi perniagaan kecil-kecilan milikan keluarga dalam proses penyerahan kuasa di Kota Kinabalu, Sabah.

Lima faktor dalaman telah dikenalpasti berhubung dengan tanggapan dengan perniagaan milikan keluarga dan kejayaan dalam perniagaan. Ia merupakan faktor-faktor yang boleh dikawal dan boleh diramalkan. Untuk mengesan impak untuk setiap faktor tersebut terhadap transisi perniagaan dan pelaksanaan perniagaan milikan keluarga, satu tinjauan telah ditujukan kepada pemilik/pengurus perniagaan milikan keluarga, mereka boleh merupakan pengasas asal, pemilik generasi yang kedua, atau pemilik generasi yang seterusnya. Dicaangkan bahawa, dalam kejayaan transisi, pewaris-pewaris biasanya dilengkapi dengan tahap pendidikan yang mencukupi, latihan dan memiliki pelbagai tahap kemahiran pengurusan melalui pengalaman pekerjaan. Selain daripada faktor-faktor tersebut, kejayaan transisi perniagaan milikan keluarga juga dipengaruhi oleh pilihan sendiri oleh pemilik perniagaan dan juga pemilihan berdasarkan jantina. Data-data yang dikumpul dan sample bersaiz 100 perniagaan-perniagaan milikan keluarga. Dengan penganalisis simple linear regression, keputusan menunjukkan implikasi faktor-

faktor ini terhadap proses transisi penyerahan kuasa bagi perniagaan-perniagaan kecil-kecilan milikan keluarga di Kota Kinabalu, Sabah.

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Lists of Abbreviation

TRA – Role of Training in the Leadership Succession Process

EDU – Role of Education as a criteria in Leadership Selection Process

FAV – Owner’s Choice of Heir in the Selection process

WEX – Important of Working Experiences

GEN – Gender Preferences in Selection Process

Chapter 1 Introduction

1.1 Background of the Study

According to a survey conducted by Arthur Anderson Center for Family Business in 1997, leadership succession management was ranked as the third as the major challenge faced by family firms in the United States (Nelton, 1997). The survey was based on a sample size of 3 033 family businesses drawn across the entire nation. The survey shown that more than 40 percent of these family businesses will change hands outright or begin to shift within the next five years, in additional, 28 percent expect their CEO to retire in the coming five years (Nelton, 1997). Further statistic given by researchers like Kets de Vries (1983) and Ward (1987) suggests that 30 percent of the first generation of family businesses survive into the second generation of family ownership, and just 15 percent survive into the third generation (Morris, Williams and Nel, 1996). According to Ward (1987), family businesses usually go out of existence after 10 years; only 3 out of 10 survive into a second generation (Kuratko and Hodgetts, 2005). Beckhard and Dyer, Jr. in their studies on managing continuity in the family-owning businesses shown that the average life expectancy for a family business is 24 years, which is also the average tenure for the founders of a business (Kuratko and Hodgetts, 2005). Professor James Lea at the University of North Carolina at Chapel Hill in his studies of the family business firms ownership and operation across the whole nation found out that only 15 percent of family businesses past into the hands of owner's children. Less than half of those will stay in the family to reach the founder's grandchildren (Tarateta, 2001). Demographics and business ownership data have shown

that a record number of privately held businesses are expected to change hands during the first two decades of the twenty-first century. And even if a business does not change owners and stays in the same family, here's an alarming fact: According to the American Society of Chartered Life Underwriters and Chartered Financial Consultants, only 35 percent of successful family businesses survive into the second generation of ownership, and only 20 percent make it into the third generation (Hamm, 2004). Furthermore, analysis published by the Canadian Association of Family Enterprise (CAFE) reveals that only three out of ten family firms make it to the next generation, and only one out of ten into the third generation. As the old adage has it, "shirt sleeves in three generations" – the founder's zeal for the success of the business, and unquestioning desire to work every hour necessary, will not necessarily be passed on as business success generates a comfortable living (Development and Learning in Organizations, 2005).

Family businesses play a more significant role in the new economy than any other type of organization. Ward (1987) defined family business as the organization when at least two generations of the family manage the business (Yusof, Perumal and Pangil, 2005). Carsrud (1994) has defined a family business as one in which both ownership and policy making are dominated by members of an emotional kinship group (Morris, Williams and Nel, 1996). Family businesses are owner-operated or managed ventures with family members predominantly involved in an administration, operations and strategic determination of corporate destiny (Poutziouris, Steier and Smyrniotis, 2004). According to an article emphasized on the crisis faced by the Canadian family firms, the role played by these firms cannot be underestimated. Small family business firms are the bedrock of the Canadian economy, whereby 94 percent of Canadian businesses being

categorized as family firms (Development and Learning in Organizations, 2005). These organizations are very important to the development and growth of the Canadian economy, in addition, these family firms are the primary sources of employment (Ibrahim, Soufani and Lam, 2003). Furthermore, family businesses employ approximately 48 percent of the workforce and nearly 50 percent of Canada's gross domestic reported to represent about one third of the *Fortune* 500 list of large firms (Ibrahim, Soufani and Lam, 2003). Despite of the importance of these businesses, their rate of survival is very low compared to other forms of organizations, for instances, partnerships and corporations. The main issue of its low survival rate is the uniqueness of family businesses with the overlap of dual identities between the family and the business systems of ownership and management (Ibrahim, Soufani and Lam, 2003). This dual identity creates some competitive advantage unique to the family business firms, but also creates serious problems associated with the interaction between family and business. These problems include conflict, succession issues, and general management problems as a result of the overlap between family and the business (Ibrahim, Soufani and Lam, 2003).

The globalization of markets, the spread of information technology and computer networks, and the dismantling of hierarchy are among the major challenges facing by today small family-owned business enterprises. In order for any family-owned to be able to survive in today's high competitive environment; leadership succession planning must be incorporate into among their most important strategy issue. Sambrook defines succession planning as the attempt to plan for the right number and quality of managers and key-skilled employees to cover retirements, death, serious illness or promotion, and any new positions which may be created in future organization plan (Sambrook, 2005).

Succession planning forms part of the human resourcing plan, which should contribute to the overall business plan. Human resource planning attempts to ensure there is a match between the demand and supply of labor, from the internal and/or external labor market. It helps calculate critical resources, including succession planning and career pathing of employees stage the business is at within the life-cycle model "start-up, growth, maturity, decline", although progression through this model is not a neat, linear process (Sambrook, 2005). According to a studies by Chung and Yuen on Chinese family-owned businesses in Hong Kong, in order for a successful succession planning, family-owned firms most finding new ideas to innovate and develop new processes in order to adapt and survive in the information age. The owners know they have to face a reality that the business may eventually die or to be taken over by new management, unless it can overcome the obstacles of passing the baton on management succession (Chung and Yuen, 2003). Morris, Williams and Nel in their studies on the factors influencing for the successful family business succession concluded that there are three major characteristics for a successful transition. First, heirs tend to be reasonably well-prepared, both in terms of their educational background and experience. They tend to start at the bottom in the company and to spend a number of years serving in a variety of capabilities throughout the organization. Second, relationships within the family are generally positive, with limited levels of conflict, rivalry, or hostility. High levels of trust and shared values are in evidence. Third, planning and control activities tend to be informal, with considerable emphasis tax planning and relatively little on succession planning. Similarly, there is little reliance on broads of directors, advisors or outside consultants (Morris, Williams and Nel, 1996).

Leadership succession in small family business firms involves the transition of

managerial decision in a firm becomes the major confrontation faced by the owners.

There are lot of emotions and politics involved in handling a business down from one

generation to another. Successful family businesses not only plan for their continuation

from generation to generation, they also debunk family business stereotypes by working

well together (Tarateta, 2001). Usually, leadership succession plans are based on

ancestral relationships in these small family business firms. While this can complicate

transitions and create significant disruptions in business performance if not managed

properly (Levitt, 2005). For the continuity of the small family business firms, it is

essential to have a succession management plan from the early stage of the firm.

Leadership succession should be linked to the firm's business strategies. An effective

leadership succession plan must be able to identify the potential candidates (Taylor and

McGraw, 2004), training of the potential candidates to be competence for a smooth

transition (Ibrahim, Soufani and Lam, 2003), and for the most important, as a strategy to

improve the survival rate of the family business firms (Ibrahim, Soufani and Lam, 2003).

Deciding who takes over the leadership of the firm on the retirement or death of the

founder is perhaps the most difficult decision of all – it is certainly the most important.

The success of the firm depends upon it, and the livelihoods and home comforts of the

family members. At the same time is at stake ambitions below or above the surface

(Development and Learning in Organization, 2005). According to Clutterbuck, a

succession planning must include the suitable candidate who will be able to step into

any significant role as it becomes vacant. Furthermore, the suitable candidate must be

motivating and developing them to be adapting to the new role as fast as possible (Clutterbuck, 2005).

1.2 Research Problems

Small family-owned small business firms play an important role in the working of the Malaysia economy; despite their importance to the economic activities and job creation it is observed that family-owned small business firms have lower survival rates than non-family firms, some argue that this can possibly be attributed to a series of factors – the necessity of training; the importance of formal education, the need of heir preparation, the necessity of work experience obtained from outside the firm, and role of gender preference in successor selection. Researchers argue that these factors are the most crucial for the survival of the small family-owned business firms and the successful of the leadership transitional process. However, most of the small family-owned business firms tend to perceive the succession as a biological necessity – the younger generation succeeds the older generation in order to ensure continuity of the business – and succession is a non-market-based transfer of leadership. The objective of this research is to explore the factors that are considered critical to an effective family-owned small business successors in Kota Kinabalu among the Chinese community.

All the problems have been mentioned above will lead the researcher to conduct a study based on the title “Factors Influencing Family Business Succession among Family-owned Small Business Firms in Kota Kinabalu.”

1.3 Objectives of the Study

The research objective of this research includes:

1. To find out the critical factors influencing the leadership succession among Chinese family-owned small family business firms in Kota Kinabalu.
2. To find out the importance of succession planning among Chinese family-owned small family business firms in Kota Kinabalu as the most major criteria for the survival and continuation of the business.
3. To assess the nature of succession processes in family-owned family small business firms in Kota Kinabalu.

1.4 Theoretical Framework on Family Firms Succession

Leadership succession continues to form the core of the family business literature.

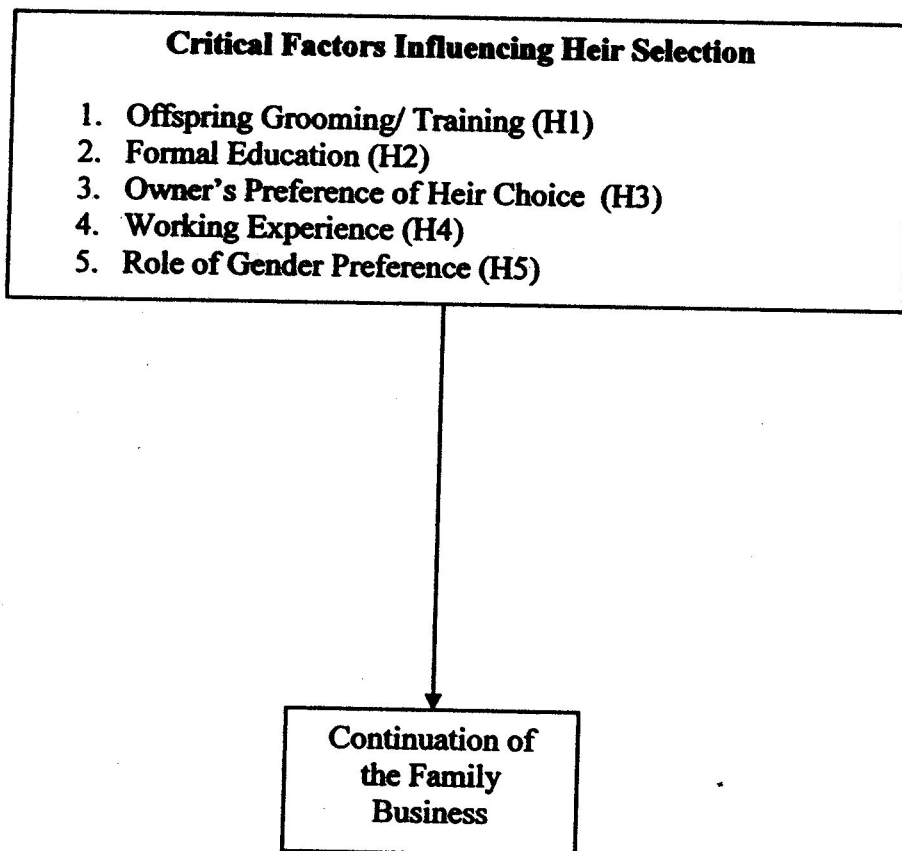
Numerous studies have suggested factors that influence the choice of successor with the succession process, but this body of work is highly fragmented and lacks a unifying framework. Family firms have been an integral part of the Malaysian economy for centuries. Firms are generally reluctant to adopt the corporate form because owners are unwilling to hand over the administration of at least part of the enterprise to next generation. Despite great changes in Malaysian economy since the independent, family business continues to play an important role, though its relative significant is certainly diminishing (Yusof, Perumal, and Pangil, 2005). A small family business has its own characteristics and advantages, besides problems and weaknesses. The vision and mission of the founder plays a significant role in determining the survival of the business in the future. The successors also play the same important role. However, not only do they need

to maintain the business success, they also have to make sure that the business that they inherit from their forefathers continues to grow (Yusof, Perumal, and Pangil, 2005).

Researcher from the western countries suggests that family business owners must prepare for leadership succession in a systematic manner to ensure continuity (Santiago, 2000).

Since the majority of the small- and medium-sized businesses in Malaysia are family operated, managed and/or controlled – in order to survive and achieve sustainable growth, becomes a major topic for researchers and practitioners (Yusof, Perumal, and Pangil, 2005; Kuratko and Hodgetts, 2004).

Family business literature indicates that succession can be viewed as a process (Ibrahim, Soufani, and Lam, 2003) with pre-selection of heir stage, selection of heir stage and post-selection stage. Succession is best viewed as a process that includes the choice of successor – pre-selection of heir stage, and their training or grooming the successor – selection of heir stage. This process socializes potential successors into the operation of the family firm and allows for eventual selection of the successor of successors. Typically, the gradual transfer of power to the next generation follows. This inter-generational transition however is generally a gradual process which the senior generation gradually withdraws from active management in the firm. Finally, the succession process does not end with the transfer of power: successful succession implies acceptance and integration of the new management – post-selection stage (Ibrahim, McGuire, Soufani, and Poutziouris, 2004).



Source: Adapted from Morris, Williams and Nel (1997); Wang, Watkins, Harris, Spicer (2004)

Figure 1: The Conceptual Model of Succession in Family Business

Not only is succession as a process studies in the academia, but also the effectiveness of this strategic procedure significant attention. The effectiveness of succession is not limited to whether a managing director/CEO/leader has been designated, but includes the ongoing health of a firm, quality of life, and family dynamics (Wang, Watkins, Harris, and Spicer, 2004). Research in relevant areas indicates that strategically many critical factors are related to the effective succession, such as succession planning (Wang, Watkins, Harris, and Spicer, 2004; Santora and Sarros, 1995 & 2001; Taylor and McGraw, 2004; McArthur and Philips, 1994, Strategic Direction, 2004), offspring grooming (Wang, Watkins, Harris, and Spicer, 2004; Ibrahim, Soufani, and Lam, 2003; Guinn, 2000), formal education (Ibrahim, Soufani, Poutziouris, and Lam, 2004; Sambrook, 2005), role of gender preference (Chung and Yuen, 2003; Kuratko and Hodgetts, 2004), outside working experience, and self-preference of successor choice by the owner (Tow and Blackford, 1992; Estess, 1997). A conceptual framework for the family-owned business firms was depicted in Figure 1. In this research, the succession process is defined as the actions and events that lead to the transition of leadership from one family member to another in family firms. The two family members may be part of the nuclear or extended family, and may or may not belong to the same generation. For succession in the family firm to occur, there must be three components: a leader who hands over the leadership role, a successor who takes over the role, and a mechanism by which the transition takes place (Barry, 1975; Sharma, James, Chrisman, Pablo and Chua, 2001).

1.5 Research Question

The research question of this paper is to find out the factors that influencing the selection of heir among the Chinese family-owned business firms in Kota Kinabalu, Sabah. This study is to find out whether the identified factors presumed to have the outcome of the sustainability of the family businesses known for its short-life span. Answering the central questions requires answering 5 preliminary questions. First, do the training plays an important role in the leadership succession process? Second, do formal education is essential that influencing the choice of heir selection? Third, do the selections of heir process must rest on the hand of the respondents' own choice? Fourth, do the important of working experience from outside the firms shall be obtain by the heirs? And finally, does gender-role play an important factor in the determination of potential heir?

1.6 Hypothesis Generation

As mentioned earlier, a number of factors in the context of family business successions have been identified by researchers and practitioners. They can be generally categorized as the following:

1. To find out the role of training in the leadership succession process.

H_1 = Training plays an important role in the leadership succession process
of family-owned small business firms in Kota Kinabalu.

2. To find out the importance of formal education as a criteria in leadership selection process.

H_2 = Formal education is very essential criteria in leadership selection